

**STATE OF WISCONSIN
DEPARTMENT OF EMPLOYEE TRUST FUNDS
801 West Badger Road
Madison, WI 53702**

CORRESPONDENCE MEMORANDUM

DATE: October 24, 2002

TO: Deferred Compensation Board Members

FROM: Mary Willett, Director

SUBJECT: Socially Responsible Investment Fund Search -
Analysis and Recommendation

At the last meeting, the Board directed staff to work with the Investment Committee to explore possible replacements for the Dreyfus Premier Third Century Fund. This fund, which is offered to participants to provide a socially responsible investment opportunity, failed to meet its performance benchmarks for 2001. The Board requested that a review be conducted to determine if there is a fund that is more appropriate to include in the Wisconsin Deferred Compensation Program (WDC) to meet participant's socially responsible investment needs.

The Investment Committee met in August and reviewed a report, prepared by Curt Morrow, Nationwide Retirement Solutions, that discussed possible replacement options. Based on this report and additional analysis provided by staff, the Investment Committee recommends the following:

- Add the Ariel Appreciation Fund, a mid-cap equity option, to the WDC's core spectrum. The historical performance of this fund compares very favorably to all other socially responsible funds that met the Board's established selection criteria.
- Close the Dreyfus Premier Third Century Fund to new participant elections and, if after the next annual review period the performance has not significantly improved, continue to remove this fund from the WDC core investment spectrum. [Note: This fund is available through the Personal Choice Retirement Account (PCRA) offerings.]
- If the Board removes the Dreyfus Fund from the WDC after the next annual review period, consideration should be given to adding a second socially responsible fund to the core options in a different asset category than the Ariel Appreciation Fund, which is a mid-cap blend fund.

Summary of Review Process

The universe of socially responsible mutual funds was examined to determine which funds met the Board's established criteria for fund selection as follows:

- Minimum five year operating history – may be waived for index funds
- Expense ratio not greater than mean for appropriate peer group
- Five-year rolling average performance must equal or exceed appropriate benchmark or index

- Minimum total asset size of \$400 million – may be waived for certain fund categories
- Anticipated WDC assets not greater than 5% of total fund – determined by comparing current WDC asset levels in a comparable fund
- No loads or sales charges unless they are waived for the WDC
- Not a sector fund

After applying the above screening criteria and removing funds that had initial minimum required deposits (e.g., \$10 million to establish an account), the following three socially responsible funds remained:

1. Ariel Appreciation Fund – mid-cap blend fund
2. Ariel Fund – small value
3. Pax World Balanced Fund – domestic hybrid option

The review of these options demonstrated that any of the three funds had better historical performance and would provide a more attractive investment opportunity than the Dreyfus Premier Third Century Fund. There is current WDC participant activity in each of these options through the PCRA. Based on data as of June 30, 2002, the Ariel Appreciation Fund was the most popular, with ten participant accounts and assets of approximately \$60,000. The Ariel Fund has three participant accounts with a balance of approximately \$63,000, and the Pax World has one account with a \$3,500 balance.

This review demonstrated that the historical performance of the Ariel Appreciation Fund would have produced the best return for participants when compared to the other two options being considered. In addition, this fund is a top performing mid-cap growth equity fund as compared to the universe of options reviewed (all publicly traded mutual funds in the *Morningstar* database).

Summary

Staff and Investment Committee members concluded that the Ariel Appreciation Fund offers a better investment opportunity to WDC participants who are seeking a socially responsible investment option than the Dreyfus Premier Third Century Fund. Based on participant interest through the PCRA, this appears to be the most popular of the options being reviewed. Therefore, the committee recommends that the Ariel Appreciation Fund be added to the core investment spectrum. If the Board approves this recommendation, staff will work with the plan administrator to add this fund to the WDC offerings effective February 2003.

Because the Dreyfus Premier Third Century Fund has again underperformed its established benchmarks (previously closed due to poor performance in August 1995), the committee is also recommending that it be closed to new participant elections effective February 2003. This action would not affect any participant who has an account in this fund (e.g., they would continue to be allowed to defer into this fund, alter deferral amounts, and not be required to exchange existing balances out of this option). If the fund's performance continues to fall short of the benchmarks for 2002, the committee recommends that the removal process continue and participants be required to redirect deferrals and transfer assets to an alternate investment.

If the Dreyfus fund fails to meet 2002 benchmarks and the Board takes action to remove it from the WDC, the committee recommends that an additional review be undertaken to determine if a second socially responsible fund in a broader asset class should be considered. Because the Ariel Appreciation Fund is a mid-cap fund, the Board may wish to consider offering a second asset class of socially responsible investing in the core spectrum.